TEXAS CAPTIVE ANNUAL REPORT INSTRUCTIONS

A. GENERAL INSTRUCTIONS

Captive insurance companies must complete the Texas Captive Annual Report in accord with Insurance Code § 964.060 and 28 Texas Administrative Code §§ 6.401 - 6.408. The Texas Captive Annual Report includes the following filings that the captive insurance company must submit to the department by the due dates described below.

- Captive Annual Report Form (CARF)–an Excel spreadsheet the captive insurance company must use in the preparation and filing of its annual reports. The captive insurance company must submit the CARF to the department no later than March 1 for the preceding calendar year or, if commissioner approval has been granted in writing for a captive insurance company to file on a fiscal year end other than a calendar year end, 60 days after the date of the captive insurance company's fiscal year end.

- Actuarial opinion including Exhibit A and Exhibit B–see Part B and Appendix A.

- Management Discussion and Analysis (MD&A)–see Part D and Appendix B.

- Updated financial projections–the captive insurance company must submit to the department with the CARF updated financial projections covering the next three-years prepared in the same format as the CARF for the balance sheet (pages 2 and 3), income statement (page 4), and cash flow statement (page 5).

- Ultimate controlling person's audited financial statements–the captive insurance company must submit a copy of the ultimate controlling person's audited financial statements to the department with the CARF, or, if not available when the CARF is submitted, within 30 days after the audited financial statements are available. The UCP's audited financial statements must be for the same reporting year as the captive insurance company's financial statements.

Basis of Accounting: The captive insurance company must prepare the required CARF financial statements using generally accepted accounting principles (GAAP) modified as follows: 1) report reinsurance reserve credits, including reserve credits for unearned premiums, as reductions from gross reserve and unearned premium liabilities, rather than as assets in accord with GAAP; and 2) letters of credit provided for original capitalization and in accord with Insurance Code 964.056 are treated as an asset of the captive insurance company.

Definitions: The terms used in this document have the same meaning as the terms defined in Insurance Code § 964.001 and 28 TAC § 6.1.

Filings: The captive insurance company must submit a copy of the CARF and all additional required documents to the department electronically in excel format to [insert TDI inbox]. The captive insurance company must not submit a pdf or other electronically imaged form of the CARF excel spreadsheet. Captive insurance companies that submit incomplete filings or that do not make filings within the prescribed timeframe are subject to penalties.

Signatures: The captive insurance company must verify the CARF under oath by affixing two executive officers' original signatures on the Jurat Page. The signatures must be notarized and submitted electronically using a scanned pdf.

Entering Data: (Placeholder for instructions)

Printing the CARF: (Placeholder for instructions.)

Spreadsheet Protection: (Placeholder for instructions.)

B. ACTUARIAL OPINION

An actuarial opinion on the reasonableness of the captive insurance company's loss and loss adjustment expense reserves is an essential and required component of the Texas Captive Annual Report and must be rendered by a qualified actuary.

Refer to Appendix A of this document for guidelines and instructions on the preparation of the actuarial opinion.

The commissioner may request an actuarial opinion more frequently that annually if the department analysis of the annual report determines that the captive insurance company's financial condition subjects its policyholders, claimants, and other creditors to unusual financial risk.

C. AUDITED FINANCIAL REPORT

An independent certified public accountant must perform an annual audit of the captive insurance company's financial statements. The audited financial report is due June 1 for the preceding calendar year, or 150 days after the CARF is due if commissioner approval has been granted for the company to file on a fiscal year end other than a calendar year end. Employees of the captive insurance company's parent or affiliates are not considered "independent" and cannot opine on the captive insurance company's financial statements. The independent certified public accountant must also provide a Letter of Qualification that must be filed with the audited financial report in accord with Insurance Code Chapter 401.

D. MANAGEMENT DISCUSSION AND ANALYSIS

The Texas Captive Annual Report requires each Texas captive insurance company to file a Management's Discussion and Analysis (MD&A) with their CARF. The MD&A must include a discussion regarding all material changes.

Refer to Appendix B of this document for instructions on the preparation of the MD&A.

E. FINANCIAL STATEMENT INSTRUCTIONS FOR PREPARING THE CARF

Page 1 - JURAT PAGE

The Jurat Page must be:

1) completed in its entirety;
2) have the original signatures of two executive officers;
3) certified by a notary public with an original stamp; and
4) submitted to the department electronically as a scanned pdf.

Officers and directors that have been newly elected during the year must have a "#" sign next to their name. The captive insurance company must submit a biographical affidavit for each of these individuals if the captive insurance company has not already done so.

The designated *Annual Report Contact Person* must be the individual responsible for preparing the CARF.

Page 2 - ASSETS PAGE

Assets reported on Page 2 must be valued in accord with GAAP unless otherwise instructed by the department. Appropriate valuation reserves must be established for any amounts where collection may be doubtful. Space has been provided for write-in miscellaneous assets for *Other Invested Assets* and *Other Assets*. Contact the department for assistance if space is insufficient for the captive insurance company's miscellaneous assets.

Cash and Invested Assets: Invested assets must be valued and reported in accord with GAAP. Do not include loans and other advances to affiliates on these lines. Captive insurance companies filing on this form are generally exempt from Texas investment limitation statutes unless instructed by the department. If you have any questions regarding these limitations, please contact the department. Amounts reported for *Cash and Cash Equivalents*, *Investments in Fixed-Maturity, and Equity Securities*, must reconcile with amounts reported on Schedule A.

Premium Receivables: This line item must include uncollected premium balances, bills receivable for premiums, and any amounts due from agents or brokers.

Reinsurance Recoverable: Reinsurance recoverable must include amounts recoverable from ceded reinsurance on paid loss and loss adjustment expenses. This line item must reconcile with the reinsurance recoverable on paid losses & LAE reported on Schedule F – Part 2.

Funds Held by Ceding Reinsurers: The amount reported on this line represents funds due and withheld from the captive insurance company by its fronting insurers and must agree to the amounts reported on Schedule F – Part 1.

Prepaid Reinsurance Premiums: Include all premiums forwarded to reinsurers on policies that are not yet in effect or due. If amounts advanced to reinsurers are material assets, details of the advances must be discussed in the captive insurance company's MD&A submitted as an attachment to the CARF.

Letters of Credit (LOC): Include the value of any outstanding LOCs that have been issued as part of the stated capitalization of the captive insurance company with the commissioner as the beneficiary. Other LOCs are inadmissible as assets in the CARF. Please identify the issuing bank, value, and terms of LOC's in the MD&A.

Investments in and Advances to Affiliates: Advances to affiliates must have received prior written approval from the department and must be reported as non-invested assets under this caption. The terms of investments in and advances to affiliates must be disclosed in the MD&A.

Other Assets: Include any other admissible assets that are not included under any other account in the balance sheet.

Page 3 - LIABILITIES, CAPITAL, AND SURPLUS PAGE

Loss and Loss Adjustment Expense Reserves (LAE): Loss and LAE reserves must be reported net of ceded reinsurance. The current year outstanding loss reserves must agree with amounts reported on Schedule P – Part 1 – Unpaid Losses, column 5. The current year outstanding Loss Adjustment Expense Reserves must agree with amounts reported on Schedule P – Part 1 – Unpaid LAE, column 10.

Unearned Premiums: Unearned premiums are reported net of amounts ceded under reinsurance agreements and must agree with the total reported for the current year on Schedule C - Premiums.

Reinsurance Payable: Include amounts currently payable to reinsurers.

Funds Held under Reinsurance Ceded: Include reinsurance premiums withheld by the captive insurance company as specified in the reinsurance contract or advances to the captive insurance company by the payment of losses before the captive insurance company makes an accounting.

Loans and Notes Payable: The captive insurance company must report all loans and notes outstanding at year-end. Material balances for this line item must be disclosed in detail in the MD&A filed concurrent with the CARF. When discussing loans and notes payable, the captive insurance company must provide details on loan terms, maturity dates and any collateral provided to secure payment.

Amounts Due to Affiliates: The captive insurance company must report all amounts due to parent or affiliates, including amounts due to asset sales and amounts due under management service agreements. Discussion of amounts paid during the year and amounts due at the statement date must be included in the MD&A accompanying the CARF. If the captive insurance company is part of an insurance holding company system, the captive insurance company must submit agreements between affiliates to the department for prior approval.

Dividends Payable: Include on this line unpaid policyholder and shareholder dividends, declared by the governing body. Policyholder's dividends require that notice be given to the commissioner within 30 days of issuing the dividends.

Taxes Payable: Taxes payable must include estimated amounts due at year-end that have not been paid plus any deferred tax liabilities.

Surplus Notes: Funds loaned to the captive insurance company and supported by a written document. The terms of surplus notes must be described in the MD&A.

Other Liabilities: Space has been provided for the captive insurance company to include all other liability items that are not included elsewhere. Please note that any material liabilities included as write-ins must be described in the MD&A.

Capital and Surplus: *Paid-in Capital* must include any issued common and preferred stock at par value. *Paid-in Surplus* is any other amount paid into the captive insurance company's capital that is in excess of the par value of stock. *Unassigned Surplus (Retained Earnings)* represents the cumulative earnings from operations and must agree with reconciliation amounts on Page 4 for *Changes in Capital and Surplus*.

Page 4 - INCOME STATEMENT

Net Earned Premiums: The current year earned premium amount must reconcile to the amount reported on Schedule C - Premiums.

Net Loss and Loss Adjustment Expense Incurred: The *Net Loss and Loss Adjustment Expense Incurred* equals the amounts paid during the current year plus any changes in reserves. *Net Loss and Loss Adjustment Expense Incurred* must agree with the amounts reported on Schedule P - Part 2 - Loss and LAE Incurred, columns 7 and 15.

Remaining Revenue and Expense Items: These items must correspond to common industry terms.

Page 5 - CASH FLOW STATEMENT

The cash flow statement must include all cash inflows and outflows that will reconcile prior-year cash and equivalents to current-year cash and equivalents.

Page 8 – SCHEDULE C - PREMIUMS

Schedule C – Premiums must disclose direct written premiums and all premiums ceded and assumed, by line, to achieve net earned premiums. Net earned premiums must agree with the amount reported on the income statement.

Pages 9 and 10 – SCHEDULE F – PART 1 REINSURANCE ASSUMED and PART 2 REINSURANCE CEDED

Schedule F Part 1 and Part 2 must disclose the breakdown of amounts ceded to and assumed from specific carriers, and any amounts securing reserves for unauthorized insurers (insurers not admitted in Texas). The totals for premiums ceded and assumed must reconcile to the Schedule C - Premiums. The MD&A must discuss any assets used to secure the captive insurance company's obligations under reinsurance agreements.

Page 11 – SCHEDULE P - PART 1 - UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

Schedule P – Part 1 must disclose the breakdown of ending reserves, net of reinsurance, by line of business.

Ending Unpaid Loss Reserves column 5 and *Unpaid LAE Reserves* column 10 must agree with the *Loss and Loss Adjustment Expense Reserves* reported on the balance sheet.

Page 12 – SCHEDULE P - PART 2 – LOSS AND LOSS ADJUSTMENT EXPENSE INCURRED

Schedule P - Part 2 - Loss and LAE Incurred, columns 7 and 15 must agree with the amounts reported on the income statement.

Pages 13 through 20 – SCHEDULE P – LOSS DEVELOPMENT BY LINE OF BUSINESS

Net loss triangles are included for each line of business on pages 13 through 20. The historical data on these schedules is carried forward from year-to-year. Separate sections are to be filled out for cumulative paid, outstanding case reserves, and IBNR. These sections are then accumulated automatically to calculate cumulative incurred losses for the current and prior years. One-year loss development of each loss year is calculated as the difference between total incurred losses for the current year less the cumulative incurred losses for that loss-year at the prior year-end.

Page 21 – SCHEDULE P – SUMMARY LOSS DEVELOPMENT - ALL LINES OF BUSINESS

This summary schedule for the aggregate of all lines of business is automatically built from links to the individual line development schedules on the previous pages. No input is required.

Pages 22 through 25 - QUESTIONNAIRE

Dropdown menus are provided to answer many questions in this section. Most questions have been designed such that the answers will be simply a “yes” or “no.” “No” answers may represent concerns that the department will focus on during its review of the filing. The captive insurance company must review these matters carefully and address the response in the space provided. If no space is provided on the questionnaire, please address the negative responses on the MD&A.

Question #1: Provide the full name of the ultimate controlling person.

Question #2: A dropdown menu is provided to answer this question as to whether the captive insurance company writes direct business, assumes business, or does both.

Questions #3 through #9: The captive insurance company must provide the individual contact name, firm name and address in response to each of these questions regarding the captive manager, service providers, and firms providing administrative services for the operations of the captive insurance company. To the extent that any of these individuals have changed from the prior report, the reasons for the change must be discussed in the MD&A. A change in a captive management company is considered a material change in the captive’s plan of operation and must have received prior approval from the department.

Question #10: Disclose if the captive insurance company insurer has a director who is a Texas resident and the identity of that director.

Question #11: Disclose if the captive insurance company insurer had a board meeting in the State of Texas and the date of that meeting.

Question #12: In response to this question the captive insurance company must provide a complete listing of all classes of capital stock outstanding. If the captive insurance company was formed as a non-stock insurer, this question must be left blank.

Question #13: This question asks if all transactions of the captive insurance company before the close of business were truthfully and accurately entered on its books.

Question #14: Disclose the largest net amount of insured/reinsured risk on any single risk per occurrence and in the aggregate.

Disclose if the aggregate risk on any single exposure has increased during the year and by what amount the risk increased. Please provide an explanation in the MD&A.

Question #15: This question asks the captive insurance company insurer to disclose if it writes deductible reimbursement coverages and to identify those coverages.

Question #16: Disclose the captive insurance company’s minimum surplus as defined in the Certificate of Authority.

Question #17: Disclose whether any changes were made during the filing year to the captive insurance company’s charter, by-laws, or organizational documents. Material changes are subject to department approval. If changes have been made, please provide a description of the change(s) made in the captive insurance company’s MD&A.

Question #18: Please select the method of accounting utilized by the captive insurance company: 1) GAAP, or 2) modified GAAP.

The department requires the captive insurance company to confirm whether it has changed its accounting method in the current annual report from the prior year. If so, please explain in the space provided.

If modified GAAP is selected, please include in the space provided a brief description of the methods of accounting used that do not conform to GAAP as required in Part A of these instructions.

Question #19: Disclose if reserves are discounted and the discount.

Question #20: Disclose if the captive insurance company has adopted a conflict of interest policy for its governing body, directors, officers, and any person that may be providing services to the captive insurance company.

Question #21: Disclose whether there have been any changes to the captive insurance company’s plan of operation and include a description of those changes in the MD&A. Changes to the plan of operation include:

- changes in affiliated and/or unaffiliated management contracts;
- changes to claims contracts;
- changes to reinsurance contracts;
- changes to loan contracts;
- changes to rates or underwriting criteria;
- changes to risk limits and retentions; and
- changes in lines written and assumed.

Question #22: Disclose if any assets of the captive insurance company or its outstanding capital stock have been pledged as collateral for any loans to the captive insurance company or its affiliates. If so, please explain in the space provided or in the MD&A.

Question #23: Disclose if the captive insurance company is only writing coverage on a direct basis, or reinsuring business produced by another carrier. This would exclude coverage on individuals and/or business entities that is defined as “controlled unaffiliated business” pursuant to Insurance Code 964.001.

If the answer to this question is “NO” and the captive insurance company is writing or assuming controlled unaffiliated business, disclose the percentage of total premiums written that relate to the controlled unaffiliated business during the year.

Question #24: For those captive insurance company insurers issuing a contractual reimbursement policy to an affiliate, disclose if the affiliate still qualifies as a self-insurer and/or if the affiliate is primarily insured with an underlying policy.

Question #25: For those captive insurance company insurers recording loans or advances to its parent or affiliate on its balance sheet, disclose if approval has been obtained from the department.

Discuss the terms of the loan or advance in the MD&A.

Question #26: Disclose if the captive insurance company is direct writing employee benefit policies subject to the Employee Retirement Income Security Act of 1974 or reinsuring employee benefits, and identify the lines of business and related amounts.

Question #27: Disclose direct written premium for risks located in the state of Texas versus risks located in all other states by line of business.

Page 23 – CROSSCHECK GUIDE: (Placeholder for instructions.)

Appendix A

ACTUARIAL OPINION

1. As part of the Texas Captive Annual Report, the captive insurance company must include the statement of a qualified actuary, entitled "Statement of Actuarial Opinion," setting forth the actuary's opinion relating to reserves specified in the SCOPE paragraph. The actuarial opinion, both the narrative and required exhibits, must be in the format of and contain the information required by these Instructions.

The captive insurance company's governing body, or a committee designated by the governing body, must appoint the qualified on or before December 31 of the calendar year for which the opinion will be rendered. The actuary must report to the governing body or the audit committee each year on the items within the scope of the actuarial opinion. The actuarial opinion and the actuarial report must be made available to the governing body.

The statement of actuarial opinion and the supporting actuarial report and work papers, must be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including ASOPs 23, 36, 41 and 43, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

1A. Definitions

"Actuarial Report" means a document or other presentation, prepared as a formal means of conveying to the state regulatory authority and the governing body the actuary's professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the actuary's opinion or findings, and documenting the analysis underlying the opinion. The required content of the report is described in paragraph 7.

"Long Duration Contracts" refers to contracts, excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts that fulfill both of the following conditions: (1) the contract term is greater than or equal to thirteen months and (2) the insurer can neither cancel nor increase the premium during the contract term.

2. The statement of actuarial opinion must consist of an IDENTIFICATION paragraph identifying the qualified actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing the actuary's opinion with respect to such subjects; and one or more additional RELEVANT COMMENT paragraphs. These four sections must be clearly designated.

3. The IDENTIFICATION paragraph must specifically indicate the actuary's relationship to the company, qualifications for acting as the company's actuary, date of appointment, and specify that the governing body, or a committee designated by the governing body, appointed the actuary.

4. The SCOPE paragraph must contain a sentence such as the following:

"I have examined the actuarial assumptions and methods used in determining reserves listed in

Exhibit A, as shown in the Captive Annual Report Form of the Company as prepared for filing with the Texas Department of Insurance, as of December 31, 20__, and reviewed information provided to me through XXX date."

Exhibit A must list those items and amounts with respect to which the actuary is expressing an opinion.

The actuary must state that the items in the SCOPE, on which he or she is expressing an opinion, reflect the disclosure items in Exhibit B.

The SCOPE paragraph must include a paragraph such as the following regarding the data the actuary used in forming the opinion:

"In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by ___________ (name, affiliation and relation to company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P of the company's annual report. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary."

5. The OPINION paragraph must include a sentence such as the following that covers at least the points listed in the following illustration:

"In my opinion, the amounts carried in Exhibit A on account of the items identified:

A. Meet the requirements of the insurance laws of (state of domicile).

B. Are computed in accord with accepted actuarial standards and principles.

C. Make a reasonable provision for all unpaid loss and loss expense obligations of the company under the terms of its contracts and agreements."

If the SCOPE includes material unearned premium reserves for long duration contracts, the OPINION must cover the following illustration:

D. "Make a reasonable provision for the unearned premium reserves for long duration contracts of the company under the terms of its contracts and agreements.

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.

If the actuary has made use of the work of another actuary, the other actuary must be identified by name and affiliation within the OPINION paragraph.

A statement of actuarial opinion must be made in accord with one of the following sections (a-e). The actuary must explicitly identify in Exhibit B which category applies.

a. <u>Determination of Reasonable Provision.</u> When the stated reserve amount is within the actuary's range of reasonable reserve estimates, the actuary must issue a statement of actuarial opinion that the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.

b. Determination of Deficient or Inadequate Provision. When the stated reserve amount is less than the minimum amount that the actuary believes is reasonable, the actuary must issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.

c. Determination of Redundant or Excessive Provision. When the stated reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary must issue a statement of actuarial opinion that the stated reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves.

d. Qualified Opinion. When, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary must issue a qualified statement of actuarial opinion. Such a qualified opinion must state whether the stated reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item, or items, to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item or items in question are not likely to be material.

e. No Opinion. The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion must include a description of the reasons why no opinion could be given.

6. The actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.

a. Risk of Material Adverse Deviation

The actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must be disclosed in $US in Exhibit B: Disclosures. The actuary must explicitly state whether he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. If such risk exists, the actuary must include an explanatory paragraph to describe the major factors, combination of factors, or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in material adverse deviation. The explanatory paragraph must not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties.

b. Other Disclosures in Exhibit B

RELEVANT COMMENT paragraphs must describe the significance of each of the remaining Disclosure items in Exhibit B. The actuary must address the items individually and in combination when commenting on a material impact.

c. Reinsurance

RELEVANT COMMENT paragraphs must address retroactive reinsurance, financial reinsurance, and reinsurance collectability. Before commenting on reinsurance collectability, the actuary must solicit information from management on any actual collectability problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year. The comment must also reflect any other information the actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The actuary's comments do not imply an opinion on the financial condition of any reinsurer.

d. Reserve Development

If the company reserves will cause the ratio of one-year development (shown in Schedule P – Summary Loss Development – All Lines of Business, Difference Between Prior and Current Year) to the prior year's surplus to be greater than 20%, the actuary must include relevant comments on the factors that led to the exceptional reserve development.

e. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change must be described in a RELEVANT COMMENT paragraph.

7. The actuarial opinion must include assurance that an actuarial report and underlying actuarial work papers supporting the actuarial opinion will be maintained at the company and available for regulatory examination for seven years. The actuarial report contains significant proprietary information. It is expected that the report be held confidential and is not intended for public inspection. The report must be available by May 1 of the year following the year-end for which the opinion was rendered or within two weeks after a request from the department.

The actuarial report must be consistent with the documentation and disclosure requirements of ASOP #41. The actuarial report must contain both narrative and technical components. The narrative component must provide sufficient detail to explain clearly to company management, the governing body, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component must provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.

The Report must also include:

- An exhibit that ties to the Captive Annual Report Form and compares the actuary's conclusions to the carried amounts on an aggregate basis and consistent with the segmentation of exposure or liability groupings used in the analysis. The actuary's conclusions must include the actuary's point estimate(s), range(s) of reasonable estimates or both.

- An exhibit that reconciles and maps the data used by the actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Captive Annual Report Form Schedule P line of business reporting.

- An exhibit or appendix showing the change in the estimates from the prior actuarial report, including extended discussion of factors underlying any material changes.

- Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.

- Extended comments on factors that led to exceptional reserve development, as defined in 6d, and how these factors were addressed in prior and current analyses.

8. The opinion must conclude with the signature of the actuary responsible for providing the actuarial opinion and the date when the opinion was rendered. The signature and date must appear in the following format:

Signature of actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

Exhibit A: SCOPE

Loss Reserves:		Amount
1. Reserve for Unpaid Losses (Liabilities, Capital and Surplus page, Col 1, Line 1)	$	
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Capital and Surplus page, Col 1, Line 2)	$	
3. Reserve for Unpaid Losses – Direct and Assumed (Must equal Schedule P, Part 1, Totals from Cols. 1 and 3)	$	
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Must equal Schedule P, Part 1, Totals from Cols. 6 and 8)	$	
5. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	$	
Premium Reserves:		
6. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	$	
7. Reserve for Net Unearned Premiums for Long Duration Contracts	$	
8. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	$	

Exhibit B: DISCLOSURES

NOTE: Exhibit B must be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.

1. Name of the Qualified Actuary Last First Mid

2. The Actuary's Relationship to the Company.

Enter E or C based upon the following:

E if an Employee of the Company or Group

C if a Consultant

3. The Actuary has the following designation (indicated by the letter code):

F if a Fellow of the Casualty Actuarial Society (FCAS)

A if an Associate of the Casualty Actuarial Society (ACAS)

M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Commissioner.

O for Other

4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following:

R if Reasonable

I if Inadequate or Deficient Provision

E if Excessive or Redundant Provision

Q if Qualified. Use Q when part of the OPINION is Qualified.

N if No Opinion

5. Materiality Standard expressed in US dollars (Used to Answer Question #6) $

6. Are there significant risks that could result in Material Adverse Deviation? Yes [ ] No [ ] Not Applicable [ ]

7. Capital and Surplus (Liabilities, Capital and Surplus page) $

8. Anticipated net salvage and subrogation included as a reduction to loss reserves $

9. Discount included as a reduction to loss reserves and loss expense reserves

9.1 Nontabular Discount $

9.2 Tabular Discount $

10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves $

11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities

11.1 Asbestos $

11.2 Environmental $

12. The total claims made extended loss and expense reserve

12.1 Amount reported as loss reserves $

12.2 Amount reported as unearned premium reserves $

13. Other items on which the Actuary is providing Relevant Comment (list separately)

$_____

______

* The reserves disclosed in item 11 above, must exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.

Appendix B

MANAGEMENT'S DISCUSSION AND ANALYSIS

As part of the Texas Captive Annual Report, the captive insurance company must include a Management Discussion and Analysis Report (MD&A) providing detailed comments regarding the captive insurance company's financial condition, changes in financial condition, and results of operations. The MD&A is particularly important to the annual filings for the captive insurance company because the Captive Annual Report Form does not include the notes to the financial statements. The MD&A must be sufficient to compensate for that lack of footnote disclosure in the annual report. The MD&A must provide information required in the following paragraphs and such other information that the captive insurance company believes necessary for understanding its financial condition, changes in financial condition, and results of operations. Liquidity and capital discussions must be combined when the two topics are interrelated.

When preparing the MD&A, give particular attention to and disclose the effects of changes in the captive insurance company's plan of operation. As required under 28 TAC § 6.304, the captive insurance company must obtain prior approval for material change to the plan of operation. It is not necessary to attach a copy of the amended plan of operation.

A captive insurance company's ability to continue to operate successfully in the short-term or long-term is dependent on the continued financial viability of its parent and affiliates. When preparing the MD&A, management must focus its commentary on the relevant relationship between the captive insurance company and its parent and affiliated companies and members. Describe in detail any material changes in the parent's and affiliate's business operations that are likely to impact the captive insurance company's financial statements.

Introduction

1. The MD&A must provide material historical and prospective textual disclosure that will enable the department to assess the captive insurance company's financial condition and results of operations. The MD&A narrative explanation of the financial statements is critical because the numerical presentation alone is insufficient for the department to judge the quality of earnings and the likelihood that past performance is indicative of future performance. A proper MD&A gives the department an opportunity to look at the captive insurance company through the eyes of its management, providing both a short and long-term analysis of the captive insurance company's business.

2. The MD&A must provide context that helps explain the financial statements and other statistical data that the captive insurance company believes will enhance the department's understanding of its financial condition, changes in financial condition, and results of operations. The discussion must address the two year period covered by the financial statements and shall use year-to-year comparisons, or any other formats that in the captive insurance company's judgment would enhance the department's understanding. Where trend information is relevant, selected financial data for extended periods of time may be necessary.

3. The MD&A provides the department with information relevant to its assessment of the captive insurance company's financial condition and results of operations and will assist the department in evaluating the amounts and certainty of cash flows from outside sources. The MD&A information need only include readily available information – without undue effort or expense – and not clearly apparent in the captive insurance company's financial statements.

4. Management must ensure balanced and fully responsive MD&A disclosure and explain the effects of the critical accounting policies, judgments made in their application, and any subsequent changes in assumptions or conditions that would have resulted in materially different reported results.

5. Focus specifically on material events and uncertainties management knows, or reasonably expects, would impact future operating results or future financial condition; including explanations, descriptions, and amounts concerning matters that (a) would have an impact on future operations, but have not had an impact in the past; and, (b) have had an impact on reported operations in the past, but are not expected to have an impact on future operations.

Results of Operations

6. Management must describe unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported net income or other surplus gains/losses and, in each case, indicate the extent to which net income or surplus was so affected. In addition, describe any other significant components of income that, in the captive insurance company's judgment, are necessary to understand the captive insurance company's results of operations.

7. Management must describe any known trends or uncertainties that have had or are reasonably probable to have a material favorable or unfavorable impact on premiums, net income, or other gains/losses in surplus. The captive insurance company must disclose knowledge or anticipation of events that may or will cause a material change in the expense and premium relationship.

8. To the extent that the financial statements disclose material increases in premium, please provide a narrative discussion of the extent to which such increases are attributable to any of the following: increases in prices or volume of existing products sold, or the introduction of new products.

Prospective Information

9. We encourage management to discuss prospective information in the MD&A, including discussions of known trends or any known demands, commitments, events, or uncertainties that will, or reasonably may, result in material changes to the captive insurance company's liquidity. Also, include descriptions of and expected changes in the mix, cost, and known material trends in the captive insurance company's capital resources. Further, management must disclose known trends or uncertainties that the captive insurance company reasonably expects will have a material impact on premium, net income or other gains/losses in surplus.

10. Management must provide such prospective information in good faith and may disclaim any responsibility for the accuracy of such prospective information.

Material Change

Management must provide adequate disclosure and analysis of the reasons for material year-to-year changes in line items as related to financial statements, and discussion and quantification of the contribution of various factors to such material changes.

11. Fully describe modifications to the captive insurance company's operating plans and their effects on financial statements.

12. Repetition and line-by-line analysis is not required or generally appropriate when the causes for a change in one line item also relate to other line items. Your discussion need not recite amounts of changes readily computable from the financial statements, however, do not merely repeat numerical

data contained in such statements; instead, provide precise quantification using dollar amounts or percentages, as reasonably practicable.

Liquidity, Asset/Liability Matching and Capital Resources

13. The term "liquidity" as used in this MD&A refers to the ability of the captive insurance company to generate adequate cash to meet the captive insurance company's cash needs. Except where it is otherwise clear from the discussion, management must indicate those balance sheet conditions, income, or cash flow items, which the management believes may be liquidity indicators. Management must discuss liquidity on both a long-term and short-term basis.

14. Short-term liquidity and short-term capital resources cover cash needs up to 12 months into the future. These cash needs and the sources of funds to meet such needs relate to the captive insurance company's day-to-day operating expenses and material commitments coming due during that 12-month period.

15. The discussion of long-term liquidity and long-term capital resources must address material expenditures, significant balloon payments or other payments due on long-term obligations, and other demands or commitments, including any off-balance sheet items, the captive insurance company will incur beyond the next 12 months, as well as the proposed funding sources required to satisfy such obligations.

16. To the extent that a captive insurance company expects to rely on funding from its parent or affiliate for short-term or long-term liquidity needs, management must describe the nature and source of that funding. Management must extend the liquidity resources discussion to describe the resources and the parent's and affiliates' ability to fulfill the potential funding needed.

17. Management must identify any known trends, demands, commitments, events, or uncertainties, likely, or reasonably likely, to result in material increases or decreases in the parent's or captive insurance company's liquidity. If you identify a material decline in liquidity, indicate the course of action that the parent or captive insurance company has taken or proposes to take to remedy the decline. Also identify and separately describe internal and external liquidity sources, and briefly discuss any material unused liquid asset sources.

18. Management must describe any known material trends, favorable or unfavorable, in the captive insurance company's capital resources and indicate any expected material changes in the mix and relative cost of such resources. Include a discussion of changes between equity, debt and any off-balance sheet financing arrangements. If the captive insurance company intends to rely on capital resources from its parent or affiliates and there are material changes in their ability to provide such resources, you must explain and discuss the resultant impact and the captive insurance company's reliance on those resources.

19. We expect management to use the statement of cash flows and other appropriate indicators in analyzing liquidity and presenting a balanced discussion dealing with cash flows from investing, financing, and operational activities. Address those matters that have materially affected the most recent period presented, but not expected to have short or long-term implications; and, conversely, those matters not materially affecting the most recent period presented, but expected to have a material effect on future periods. Examples include:

a) Changes in discretionary operating expenses;

b) Changes in investments or loans to its parent and affiliates, and the parent's or affiliate's ability to fulfill commitments or provide returns under those agreements or investments;

c) Dividend requirements to the captive insurance company's parent to fund the parent's operations or debt service; or,

d) Future potential sources of capital, such as the form and amount of a parent's planned investment in the captive insurance company.

20. MD&A disclosures must not be overly general. For example, merely stating "the captive insurance company has sufficient short-term funding to meet its liquidity needs for the next year" provides little useful information for the department. Instead, management must specifically describe the short-term funding sources and circumstances reasonably likely to affect those liquidity sources. Rather than offer "boilerplate" language, limit the discussion to material risks, and, as with the MD&A generally, be sufficiently detailed and tailored to the captive insurance company's individual circumstances.

21. Management must identify and disclose "reasonably likely" circumstances that could materially affect liquidity, i.e., market price changes, economic downturns, defaults on guarantees, or parent or affiliate contractions of operations materially affecting the captive insurance company's financial position or operating results.

22. When identifying trends, demands, commitments, events and uncertainties that require disclosure, management must consider the following:

a) Provisions in financial guarantees or commitments, debt agreements, or other arrangements that could trigger an early payment, additional collateral support, changes in terms, acceleration of maturity, or the creation of an additional financial obligation, such as adverse credit ratings changes, financial ratios, earnings, or cash flows;

b) Circumstances that could impair the parent's or the captive insurance company's ability to continue to engage in transactions previously integral to historical operations, or financially or operationally essential, or that could render that activity commercially impracticable, such as the inability to maintain earnings levels, financial ratios, or collateral; and,

c) Factors specific to the captive insurance company and its parent's markets that the captive insurance company expects to be significant to the captive insurance company's or its parent's ability to raise short-term and long-term financing.

Loss Reserves

23. The MD&A must include a discussion of items and description of contributing risks that affect loss reserve volatility.

24. To the extent there have been significant changes in the reserving practices during the period, management must disclose and discuss the reasons for making those changes along with their affects on current and future captive insurance company operations. Consider all changes in reserving practices, whether or not they result in significant current financial statement impact, as material changes to a captive insurance company's plan of operation that require the prior department approval.

Conclusion

25. The MD&A gives the department the opportunity to look at the captive insurance company through the eyes of its management, providing a historical and prospective analysis of the captive

insurance company's financial condition and results of operations, with particular emphasis on the captive insurance company's prospects for the future. The MD&A requirements are intentionally flexible and general. Because no two captive insurance companies are identical, an appropriate MD&A disclosure for one captive insurance company is not necessarily an appropriate MD&A disclosure for another. The same is true for MD&A disclosure of the same captive insurance company in different years. The department intends the MD&A to be a flexible framework for providing the department with appropriate information concerning the captive insurance company's financial condition, changes in financial condition, and results of operations.